DCU BULLETIN

Division of Credit Unions

Washington State Department of Financial Institutions

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Focus on Liquidity

Over the last 18 months, many Washington State chartered credit unions have shown a downward trend in cash and short-term investments. Due to this downward trend, examiners will expand their liquidity analysis for credit unions with low liquidity levels to ensure credit unions have other sources of contingency liquidity to safely manage liquidity pressure. Additionally, examiners will analyze the credit unions compliance with the requirements outlined in 12 CFR 741.12. Generally, credit unions should maintain an adequate balance sheet cushion of highly liquid assets as a basic element of liquidity risk management. Credit unions of all sizes must hold an adequate safeguard of cash and cash equivalents on the balance sheet continuously.

The examiners' liquidity review will include, but is not limited to, the following:

- Liquidity policy and contingency funding plan;
- Cash flow forecast; and
- Liquidity testing and monitoring.

<u>Liquidity Policy and Contingency Funding Plan</u>

The board of directors must determine the appropriate tolerance for liquidity risk by establishing the purpose, objective and goals of liquidity management. The liquidity policy and contingency funding plan should be tailored to the size and complexity of the credit union and should address both low and excessive cash flows.

Examiners will focus on the following items:

- The primary and secondary sources of liquidity;
- Balance sheet composition;
- Uses of borrowed funds;
- Maximum/minimum liquidity ratio limits;
- Appropriate limits such as total loans to shares thresholds and the cash plus short-term investments to assets ratios;
- Contingency funding sources and triggers; and
- The Asset Liability Management Committee and the Board reporting requirements.

As outlined in 741.12(d), a credit union over $50 million in assets must have a written contingency funding plan based on its complexity, risk profile and scope of operations that sets out the strategies for addressing liquidity shortfalls in emergency situations. Examiners with review the funding plans to ensure credit unions have appropriately identified and have access to multiple sources of funding. These funding sources should include both funds from the credit union's own balance sheet and through market funding sources. Credit unions with more than $250 million in total assets must establish at least one federal source of contingent liquidity.

Cash Flow Forecast

Forecasts must be based on anticipated changes in cash flow and should include, but not limited to, the following:

- Estimated loan demand and expected loan repayment amounts;
- Share and deposit inflows and outflows;
- Investment maturities, purchases and anticipated payments received;
- Contingent liabilities;
- Operating expenses; and
- Earnings.

Effective forecasting and planning will help anticipate liquidity needs before they arise and will provide for timely consideration of potential solutions.

Testing and Monitoring

Credit union management should monitor current liquidity levels to ensure they are within the established limits and proactively take action when necessary to restore liquidity to appropriate levels. Also, management should periodically review cash flow projections and periodically test using its contingency funding sources.

The Division understands that liquidity management does not have a one-size fits all approach and that the success of an effective liquidity management program is dependent upon a credit union's business model, size, and complexity.

Any questions regarding this Bulletin should be directed to Tammie Nuber, Chief of Safety and Soundness Examinations, at Tammie.Nuber@dfi.wa.gov or 360.902-8717.

Additional guidance:

NCUA Letter to Credit Unions No 13-CU-10 Guidance on How to Comply with NCUA Regulation Liquidity and Contingency Funding Plans